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RESEARCH ARTICLE

Reply to "Modeling Managerial Altruism, CSR, and Donations: A Comment"

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We point out that the main concern of this comment is on the assumptions about "managerial compensation" and "who should make the donation decision for the firm".

We appreciate this interesting comment to Ho and Huang (2017). The main concern of this comment is on the assumptions about "managerial compensation" and "who should make the donation decision for the firm".

In our setup, the managerial compensation is a proportion of operation profit, that is, the profit from market competition, and before market competition, in the second stage it is the manager who will make the donation decision. Our main point is when making the donation decision, the manager faces a trade-off between "his interest conflict with the owner" (i.e., β_i) and the "altruistic preference" (i.e., θ). The total cost for donation will include a direct cost d_i and an quadratic donation cost $\frac{c(d_i)^2}{2}$. The quadratic assumption is a conventional setup to ensure that the manager's maximization problem is well defined, so that we have interior solutions.

In this comment, the authors assume that the managerial compensation is a proportion of overall profit (i.e., profit from market competition minus donations), and it is the owner who will make the donation decision. Hence, the owner's maximization problem becomes

$$\max_{d_i} \pi_i^*(d_i, d_j) - d_i.$$

The authors raised two problems with their setup. (a) With a linear cost (i.e., d_i), the optimal value of d_i for the above maximization problem will be a corner solution. That is, depending on the parameters, d_i can be zero or ∞. For the latter case, the authors describe that "it seems in the interest of the owner that the firm makes as much donations as possible". (b) Given that the firm owner has made the above donation decision, the manager then faces again the maximization problem with his "altruistic preference" (i.e., θd_i), donation cost d_i, and the opportunity cost $\frac{c(d_i)^2}{2}$. As described by the authors, the donation cost will be double charged: "Donation cost is taken into consideration twice, be it at different values".

Despite the differences in the model setup, our assumption about β_i is meant to capture the interest conflict between manager and owner. Since our focus is on donation's strategic meaning, we did not address the moral hazard or adverse selection problems in this agency relation. We can set β_i to be one, and this will not change the main conclusions in Ho and Huang (2017).

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